## ANSWER OF MODEL TEST PAPER 2

## INTERMEDIATE COURSE: GROUP – I

## PAPER – 1 : ADVANCED ACCOUNTING

**1. (i) (c)**

**(ii) (b)**

**(iii) (c)**

**(iv) (d)**

**2. (i) (a)**

**(ii) (a)**

**(iii) (b)**

**(iv) (a)**

**(v) (b)**

**3. (i) (b)**

**(ii) (a)**

**(iii) (b)**

**4. (a)**

**5. (d)**

**6. (a)**

### PART II – Descriptive Questions (70 Marks)

**1. (a)** As per AS 26 "Intangible Assets", expenditure on research should be recognized as an expense when it is incurred. An intangible asset arising from development (or from the development phase of an internal project) should be recognized if, and only if, an enterprise can demonstrate all of the conditions specified in para 44 of the standard. An intangible asset (arising from development) should be derecognised when no future economic benefits are expected from its use according to para 87 of the standard. Thus, the manager cannot defer the expenditure write off to future years in the given case.

Hence, the expenses amounting ₹ 40 lakhs incurred on the research and development project has to be written off in the current year ending 31st March, 2024.

**(b) (i)** As per AS 2 'Valuation of Inventories', abnormal amounts of wasted materials, labour and other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred. The normal loss will be included in determining the cost of inventories (finished goods) at the year end.

**(ii)** Material used 16,000 MT @ ₹ 190 = ₹ 30,40,000

| | | |
|---|---|---|
| | Normal Loss | (5% of 16,000 MT) 800 MT (included in calculation of cost of inventories) |
| | Net quantity of material | 15,200 MT |
| **(iii)** | Abnormal Loss in quantity | (950 - 800) 150 MT |
| | Abnormal Loss | ₹ 30,000 |

[150 units @ ₹ 200 (₹ 30,40,000/15,200)]

Amount of ₹ 30,000 (Abnormal loss) will be charged to the Profit and Loss statement.

**(c)** As per AS 13 (Revised) 'Accounting for Investments', where long-term investments are reclassified as current investments, transfers are **made at the lower of cost and carrying amount** at the date of transfer; and where investments are reclassified from current to long term, transfers are made **at lower of cost and fair value** on the date of transfer.

Accordingly, the re-classification will be done on the following basis:

(i) In this case, carrying amount of investment on the date of transfer is less than the cost; hence this re-classified current investment should be carried at ₹ 12 lakhs in the books.

(ii) In this case, reclassification of current investment into long-term investments will be made at ₹ 7 lakhs as cost is less than its fair value of ₹ 8.5 lakhs on the date of transfer.

**2. Oliva Company Ltd.**

**Statement of Profit and loss for the year ended 31.03.2024**

| | Particulars | Note | Amount (₹) |
|---|---|---|---|
| I | Revenue from operations | | 17,10,000 |
| II | Other income (3,900 +300) | | 4,200 |
| III | **Total Revenue (I +II)** | | 17,14,200 |
| IV | Expenses: | | |
| | Cost of materials consumed | 10 | 12,64,200 |
| | Purchases of inventory-in-trade | | -- |
| | Changes in inventories of finished goods, work-in-progress and inventory-in-Trade | 11 | (13,500) |
| | Employee benefit expenses | 12 | 44,700 |
| | Finance costs | | -- |
| | Depreciation and amortization expenses | | 18,240 |
| | Other expenses | 13 | 3,51,510 |
| | **Total Expenses** | | 16,65,150 |
| V | Profit before exceptional and extraordinary items and tax | | 49,050 |

| | | | |
|---|---|---|---|
| VI | Exceptional items | | -- |
| VII | Profit before extraordinary items and tax | | 49,050 |
| VIII | Extraordinary items | | -- |
| IX | Profit before tax | | 49,050 |
| X | Tax expense (40% of 49,050) | | 19,620 |
| XI | Profit/Loss for the period from continuing operations | | 29,430 |

**Oliva Company Ltd.**
**Balance Sheet for the year ended 31.03.2024**

| | Particulars | Note | Amount |
|---|---|---|---|
| **1** | **Equity and Liabilities** | | |
| | **(i)** Shareholders' funds | | |
| | (a) Share Capital | | 3,15,000 |
| | (b) Reserves and surplus | 1 | 50,430 |
| **2)** | **Non-current liabilities** | | |
| | (a) Long-term borrowings | 2 | 24,300 |
| **(3)** | **Current Liabilities** | | |
| | (a) Short -term borrowings | 3 | 6,000 |
| | (b) Trade payables | | 3,27,000 |
| | (c) Other current liability | 4 | 72,000 |
| | (d) Short term provision | 5 | 19,620 |
| | | | 8,14,350 |
| **II** | **ASSETS** | | |
| **(1)** | **Non current assets** | | |
| | (a) Property, Plant & equipment | 6 | 2,04,160 |
| | (b) Non-current investments | | 7,500 |
| **(2)** | **Current assets** | | |
| | (a) Current investments | | 4,500 |
| | (b) Inventories | 7 | 85,800 |
| | (c) Trade receivables | | 2,38,500 |
| | (d) Cash and cash equivalents | | 2,71,100 |
| | (e) Short-term loans and advances | 8 | 2,490 |
| | (f) Other current assets | 9 | 300 |
| | | | 8,14,350 |

**Notes to accounts**

| No. | Particulars | | Amount | Amount |
|---|---|---|---|---|
| 1. | **Reserve & Surplus** | | | |
| | Profit & Loss Account: Balance b/f | | 48,000 | |
| | Net Profit for the year | | 29,430 | |
| | Less: Interim Dividend | | (27,000) | 50,430 |
| 2. | **Long term borrowings** | | | |
| | Secured loans | | 21,000 | |
| | Fixed Deposits: Unsecured | | 3,300 | 24,300 |
| 3. | **Short term borrowings** | | | |
| | Secured loans | | 4,500 | |
| | Fixed Deposits -Unsecured | | 1,500 | 6,000 |
| 4. | **Other current liabilities** | | | |
| | Expenses Payable (67,500 + 4,500) | | | 72,000 |
| 5. | **Short term provisions** | | | |
| | Provision for Income tax | | | 19,620 |
| 6. | **PPE** | | | |
| | Building | 1,01,000 | | |
| | Less: Depreciation @ 2% | (2,020) | 98,980 | |
| | Plant & Machinery | 70,400 | | |
| | Less: Depreciation @ 10% | (7,040) | 63,360 | |
| | Furniture | 10,200 | | |
| | Less: Depreciation @ 10% | (1,020) | 9,180 | |
| | Motor vehicles | 40,800 | | |
| | Less: Depreciation @ 20% | (8,160) | 32,640 | 2,04,160 |
| 7 | **Inventory** | | | |
| | Raw Material | | 25,800 | |
| | Finished goods | | 60,000 | 85,800 |
| 8. | **Short term Loans & Advances** | | | |
| | General Charges prepaid | | | 2,490 |
| 9. | **Other Current Assets** | | | |
| | Interest accrued | | | 300 |
| 10. | **Cost of material consumed** | | | |
| | Opening inventory of raw material | 30,000 | | |
| | Add: Purchases | 12,15,000 | | |

| | | | | |
|---|---|---|---|---|
| | Stores & spare parts consumed | 45,000 | 12,90,000 | |
| | Less: Closing inventory | | (25,800) | 12,64,200 |
| 11. | **Changes in inventory of Finished Goods & WIP** | | | |
| | Closing Inventory of Finished Goods | | 60,000 | |
| | Less: Opening Inventory of Finished Goods | | 46,500 | 13,500 |
| 12. | **Employee Benefit expenses** | | | |
| | Salary & Wages (40,200 + 4,500) | | | 44,700 |
| 13. | **Other Expenses** | | | |
| | Manufacturing Expenses (2,70,000 + 67,500) | | 3,37,500 | |
| | General Charges (16,500 – 2,490) | | 14,010 | 3,51,510 |

**3. (a)** As per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

It is apparent from the question that the company had not made provision for warranty in respect of certain goods considering that the company can claim the warranty cost from the original supplier. However, the provision for warranty should have been made as per AS 29 and the amount claimable as reimbursement should be treated as a separate asset in the financial statements of the company rather than omitting the disclosure of such liability. Accordingly, it is viewed that the accounting treatment adopted by the company with respect to warranty is not correct.

**(b) Balance Sheet of Radhika Ltd. (and Reduced) as on 1.4.2024**

| | Particulars | Notes | ₹ |
|---|---|---|---|
| I. | Equity & Liabilities | | |
| A | Shareholders' Fund | | |
| a | Share Capital | 1 | 3,16,800 |
| b | Reserves & Surplus | 2 | 1,10,200 |
| B | Non-Current Liabilities | | |

| | | | |
|---|---|---|---|
| a | Long Term Borrowings | 3 | 7,86,000 |
| C | Current Liabilities | | |
| a | Trade Payables | | 3,60,000 |
| b | Short Term borrowings: Bank OD | | 2,34,000 |
| | Total | | 18,07,000 |
| II. | <u>Assets</u> | | |
| A | Non-Current Assets | | |
| a | Property, Plant & Equipment | 4 | 7,09,000 |
| b | Intangible assets: Patents | | 45,000 |
| B | Current Assets | | |
| a | Inventory (5,10,000-65,000) | | 4,45,000 |
| b | Trade Receivable | 5 | 4,31,500 |
| c | Cash & Cash Equivalent | | 1,76,500 |
| | Total | | 18,07,000 |

**Notes to Accounts**

| | **Particulars** | **₹** |
|---|---|---|
| 1 | Share Capital | - |
| | Authorised, Issued, Subscribed & Paid Up Capital | |
| | Equity share Capital | |
| | 15,840 Shares of ₹20 Paid up | <u>3,16,800</u> |
| | (Out of above 6,840 shares are issued for consideration other cash) (W.N 1) | |
| 2 | Reserves & Surplus | |
| | Capital Reserve (W.N 2) | 1,10,200 |
| 3 | Long Term Borrowings Secured | |
| | 6% Debentures | 4,50,000 |
| a<br>b | 11% Debentures (70% of 4,80,000 preference shares) | <u>3,36,000</u> |
| | | <u>7,86,000</u> |
| 4 | PPE | |
| | Freehold property | 6,49,000 |
| | Plant | <u>60,000</u> |
| | | <u>7,09,000</u> |
| 5 | Trade receivable | 5,00,000 |
| | Less: Provision for Doubtful Debts | <u>(68,500)</u> |
| | | <u>4,31,500</u> |

**Working notes:**

1. **Computation of equity shares:**

| | | | **Equity share capital** | **No. of shares at ₹ 20 each** |
|---|---|---|---|---|
| 1 | After the reduction to ₹ 20 each | 90,000 x 20 | 1,80,000 | 9,000 |
| 2. | Equity shares allotted to preference shareholders for their ¼ arrears. | 6% of 4,80,000 | 28,800 | 1,440 |
| 3. | Equity shares allotted to Directors in settlement of their loan | 90% of 1,20,000 | 1,08,000 | 5,400 |
| | Total equity shares | | 3,16,800 | 15,840 |

2. Calculation of capital reserve: Equity Share 7,20,000 + Preference share 1,44,000 + Freehold property 1,39,000 +Investment 74,000 + Director Loan 6,000 – Preference share dividend 28,800 - Goodwill 1,56,000 – Inventory 65,000 – Bad debts 68,500 – Profit & Loss A/c 6,42,000 = Capital Reserve 1,22,700

3. Cash balance:

| | | ₹ |
|---|---|---|
| Cash & cash equivalent | | 82,000 |
| Add: Investment sold | | 1,40,000 |
| Less: Directors Loan (1,20,000 x 5%) | 6,000 | |
| Penalty (2,50,000x 5%) | 12,500 | |
| Interest on debentures (6% on 4,50,000) | 27,000 | 45,500 |
| | | 1,76,500 |

**4. Calculation of Net Assets**

| **Particulars** | **Anu Ltd. (₹)** | **Banu Ltd. (₹)** |
|---|---|---|
| Goodwill | 1,75,000 | 50,000 |
| Freehold property | 3,75,000 | 3,00,000 |
| Plant & Machinery | 1,25,000 | 50,000 |
| Motor vehicle | 37,500 | 25,000 |
| Trade receivable | 2,50,000 | 1,00,000 |
| Inventory | 2,87,500 | 2,25,000 |
| Cash at Bank | 1,00,000 | 50,000 |
| Total | 13,50,000 | 8,00,000 |

| | | |
|---|---|---|
| Less : Trade payable | (2,62,500) | (1,62,500) |
| 6% debentures | - | (1,57,500) |
| Net Assets | 10,87,500 | 4,80,000 |

**Calculation of Purchase Consideration**

| Sr. No. | Particulars | Computation | Anu Ltd | Banu Ltd |
|---|---|---|---|---|
| 1 | Amount payable to Equity Share Holder in the form of | | | |
| | 1,08,750 Equity shares of ₹10 each | (1,08,750 × 10) | 10,87,500 | |
| | 48,000 Equity shares of ₹10 each | (48,000 × 10) | | 4,80,000 |
| | Purchase Consideration | | 10,87,500 | 4,80,000 |

**Balance Sheet of Anban Ltd.**
**as on 1st April, 2023**

| | Particulars | Note No. | ₹ |
|---|---|---|---|
| | Equity and Liabilities | | |
| (1) | Shareholders' Funds | | |
| (a) | Share Capital | 1 | 15,67,500 |
| (2) | Non-current Liabilities | | |
| (a) | Long term borrowings | 2 | 1,57,500 |
| (3) | Current Liabilities | | |
| (a) | Trade Payables (2,62,500 + 1,62,500) | | 4,25,000 |
| | Total | | 21,50,000 |
| | Assets | | |
| (1) | Non-current Assets | | |
| (a) | Property Plant and Equipment | 3 | 9,12,500 |
| (b) | Intangible assets | 4 | 2,25,000 |
| (2) | Current Assets | | |
| (a) | Inventories (2,87,500 + 2,25,000) | | 5,12,500 |
| (b) | Trade Receivables (2,50,000 + 1,00,000) | | 3,50,000 |
| (c) | Cash and cash equivalents (1,00,000 + 50,000) | | 1,50,000 |
| | Total | | 21,50,000 |

**Notes to Accounts:**

| Note No. | Particulars | ₹ |
|---|---|---|
| 1 | Share Capital | |
| | Equity share capital | |
| | 1,56,750 equity shares of ₹10 each | 15,67,500 |
| | (out of above shares are issued for consideration other than cash) | |
| 2 | Long term borrowings | |
| | 6% Debentures | 1,57,500 |
| 3 | Property, Plant & Equipment's | |
| | Freehold property (3,75,000 + 3,00,000) | 6,75,000 |
| | Plant & Machinery (1,25,000 + 50,000) | 1,75,000 |
| | Motor Vehicle (37,500+25,000) | 62,500 |
| | | 9,12,500 |
| 4 | Intangible assets | |
| | Goodwill (1,75,000 + 50,000) | 2,25,000 |

**5. (a) Revalued net assets of Moon Ltd.as on 31st March, 2024**

| | ₹ in lakhs | ₹ in lakhs |
|---|---|---|
| Property, plant and equipment [240 x 120%] | | 288.0 |
| Investments [110 X 90%] | | 99 |
| Current Assets | | 140.0 |
| Loans and Advances | | 30.0 |
| Total Assets after revaluation | | 557 |
| Less: 15% Debentures | 180.0 | |
| Current Liabilities | 100.0 | (280.0) |
| Equity / Net Worth | | 277 |
| Star Ltd.'s share of net assets (70% of 277) | | 193.9 |
| Star Ltd.'s cost of acquisition of shares of Moon Ltd. | | |
| (₹ 140 lakhs – ₹ 14 lakhs*) | | 126.00 |
| Capital reserve | | 67.9 |

| | |
|---|---|
| * Total Cost of 70 % Equity of Moon Ltd. | ₹ 140 lakhs |
| Purchase Price of each share | ₹ 20 |
| Number of shares purchased [140 lakhs /₹ 20] | 7 lakhs |
| Dividend @ 20 % i.e. ₹ 2 per share | ₹ 14 lakhs |

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

**(b) Impact of Revaluation of Plant and Machinery will be as -**

| | ₹ |
|---|---:|
| Book value of Plant and Machinery as on 01-04-2023 | 2,25,000 |
| Depreciation Rate $\frac{(2,25,000-2,02,500)}{2,25,000}$ = 22,500/2,25000 x100 | 10% |
| Book value of Plant and Machinery as on 01-10-2023 after six months depreciation @10% (2,25,000-11,250) | 2,13,750 |
| Revalued at | 2,70,000 |
| Revaluation profit (2,70,000-2,13,750) | 56,250 |
| Share of Gamma Limited in Revaluation Profit (80%) | 45,000 |
| Share of Minority in Revaluation profit (20%) | 11,250 |
| Additional Depreciation on appreciated value to be charged from post-acquisition profits | |
| (10% of ₹ 22,5,000 for 6 months) + (10% of ₹ 2,70,000 for 6 months) less ₹ 22500 (as already charged) | 2,250 |
| Share of Gamma Limited in additional depreciation that will reduce its share (80%) in post-acquisition profit by | 1,800 |
| Share of Minority Interest in additional depreciation | 450 |

**Working note:**

Percentage of holding:

| | | No. of Shares | Percentage |
|---|---|---|---|
| Holding Co. | : | 24,000 | (80%) |
| Minority shareholders | : | 6,000 | (20%) |
| TOTAL SHARES | : | 30,000 | |

**6. (a)** Yes, one of the characteristics of financial statements is neutrality. To be reliable, the information contained in financial statement must be neutral, that is free from bias. Financial Statements are not neutral if by the selection or presentation of information, the focus of analysis could shift from one area of business to another thereby arriving at a totally different conclusion on the business results.

**Or**

**Effects of each transaction on Balance sheet of the trader is shown below:**

| **Transactions** | **Assets ₹ lakh** | **–** | **Liabilities ₹ lakh** | **=** | **Equity ₹ lakh** |
|---|---|---|---|---|---|
| Opening | 16.00 | – | 6.00 | = | 10.00 |
| (1) Dividend earned | 16.40 | – | 6.00 | = | 10.40 |
| (2) Settlement of Creditors | 15.40 | - | 4.60 | = | 10.80 |
| (3) Rent Outstanding | 15.40 | – | 4.80 | = | 10.60 |
| (4) Drawings | 15.22 | – | 4.80 | = | 10.42 |

**(b) Journal Entries**

| | | | ₹ | ₹ |
|---|---|---|---|---|
| 2022 | Equity Share Capital A/c | Dr. | 4,00,000 | |
| June | To Equity Stock A/c | | | 4,00,000 |
| | (Being conversion of 4,000 fully paid Equity Shares of ₹ 100 into ₹ 4,00,000 Equity Stock as per resolution in general meeting dated…) | | | |
| 2023 | | | | |
| June | Equity Stock A/c | Dr. | 4,00,000 | |
| | To Equity Share Capital A/c | | | 4,00,000 |
| | (Being re-conversion of ₹ 4,00,000 Equity Stock into 40,000 shares of ₹ 10 fully paid Equity Shares as per resolution in General Meeting dated...) | | | |

**(c) Books of Head Office**

**Branch Stock Account**

| | ₹ | | ₹ |
|---|---|---|---|
| To Balance b/d – Op Stock | 30,000 | By Branch Debtors (Sales) | 1,65,000 |
| To Goods Sent to Branch A/c | 2,40,000 | By Branch Cash | 59,000 |
| To Branch Adjustment A/c | 2,000 | By Balance c/d | |

| | | | |
|---|---|---|---|
| (Balancing Figure – Excess of Sale over Invoice Price) | | Goods in Transit (₹ 2,40,000 – ₹ 2,20,000) | 20,000 |
| | | Closing Stock at Branch | 28,000 |
| | 2,72,000 | | 2,72,000 |

**Branch Debtors Account**

| | ₹ | | ₹ |
|---|---|---|---|
| To Balance b/d | 32,750 | By Bad debts written off | 750 |
| To Branch Stock A/c (Sales) | 1,65,000 | By Branch Cash (bal. fig.) | 1,71,000 |
| | | By Balance c/d | 26,000 |
| | 1,97,750 | | 1,97,750 |